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Weekly Highlights
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- The GOA sells USD 482 million worth of Boden 2012 bonds to
Venezuela.
- CPI rises 0.6 percent m-o-m in July -- below market expectations.
PPI rises 0.7 percent m-o-m.
- The Chamber of Deputies approves budget "superpowers".
- Chilean industrialists denounce Argentina gas delivery cut.
- IDB approves two credit lines to Argentina provinces.
- The Minimum, Vital and Mobile Wage Council agrees to increase the
minimum wage 27 percent.
- Commentary of the Week: "The Internal Market or Exports?"

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The GOA sells USD 482 million worth of Boden 2012 bonds to
Venezuela.
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¶1. On July 28, the GOA published a resolution authorizing the issuance of USD 482 million worth of Boden 2012 bonds to Venezuela, although the bond placement was made secretly on July 17. With this new issuance, Boden 2012 stock has reached USD 15.1 billion, of which more than one-quarter was sold directly to the GOV.

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CPI rises 0.6 percent m-o-m in July -- below market expectations.
PPI rises 0.7 percent m-o-m.
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¶2. The Consumer Price Index (CPI) increased 0.6 percent m-o-m in July, below market expectations of 1 percent, and one-tenth of a percentage point higher than in the last two months. The better-than-expected result is due mainly to reduced pressure on food prices, which make up almost one-third of the index. Last month's increase brought inflation to 5.5 percent for the first seven months of the year, compared to a 7.2 percent increase in the same period last year. The seasonal component of the index increased 0.3 percent, while the regulated component increased just 0.1 percent. The categories with the highest price increases were education (+4 percent), recreation (+3.1 percent) and housing (+2.5 percent). Meat prices (representing 4.5 percent of the consumer basket) decreased 3 percent m-o-m due to price restraint agreements

between the GOA and the meat sector as well as the partial ban on beef exports. Year-on-year, CPI increased 10.6 percent. The BCRA consensus survey forecasts 11.5 percent inflation in 2006, unchanged from last month's forecast. The 2006 budget projects a 9.1 percent inflation rate for 2006, and the Central Bank's inflation target range is 8-11 percent.

¶3. Producer prices increased 0.7 percent m-o-m in June, due to a 1.3 percent increase in primary goods prices and a 0.5 percent increase in the prices of manufactured goods prices and electricity. The price of imported goods increased 0.4 percent. The PPI index increased 11.4 percent y-o-y.

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The Chamber of Deputies approves budget "superpowers."
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¶4. On August 2, the Chamber of Deputies approved the budgetary "superpowers" bill sought by the GOA, thus passing the bill into law. The so-called "superpowers" over the national budget will give the GOA the power to modify the Budget Law and give the Chief of Cabinet the power to reallocate funds irregardless of the provisions of the Financial Administration Act or the Fiscal Responsibility Law. The Senate amended the original proposal, adding a clause that these "superpowers" will not extend to SIDE (Argentine intelligence service) or to confidential funds (the so-called "fondos reservados"). While past administrations also have had similar "superpowers," this law is different in that the powers granted to the Chief of Cabinet will be permanent, rather than temporary.

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Chilean industrialists denounce Argentina gas delivery cut.
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¶5. Several Chilean industrialists denounced the recent reduction in

gas imports from Argentina, which has limited supplies to small consumers only. Argentine energy planners will reduce exports to Chile, as well as restrict supplies to domestic companies and gas stations. The reported cut in gas delivery coincided with the coldest days in Argentina's winter; such gas restrictions are not out of the ordinary when residential users increase demand during cold spells. This criticism exacerbates tensions between Argentina and Chile, after GOC officials remarked that Argentina's gas price increase was higher than expected.

¶6. The GOA responded to the GOC's criticisms, justifying the price hike as a result of the increased price of gas imported from Bolivia to Argentina.

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IDB approves two credit lines to Argentina provinces.
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¶7. The Inter-American Development Bank (IDB) approved two credit lines to Argentina provinces. Cordoba province will receive a USD 180 million loan for an education, home and hospital development program. The IDB also approved a USD 580 million credit to finance a high-tension line to boost energy distribution across the "Great North" provinces (Catamarca, Corrientes, Chaco, Formosa, Jujuy, Misiones, Tucuman, Salta and Santiago del Estero). The loans have 25-year terms and a 4-year grace period for repayment at variable interest rates.

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The Minimum, Vital and Mobile Wage Council agrees to increase the minimum wage 27 percent.
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¶8. On July 28, the Minimum, Vital and Mobile Wage Council participants (union leaders, employers and government employees) reached an agreement to gradually increase the minimum wage between now and November. On August 1, the minimum wage increased from ARP 630 to ARP 760. It will rise to ARP 780 in September, and finally to ARP 800 in November. Union leaders are still demanding an increase in the family allocation from ARP 60 to ARP 75 per child.

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Tax revenues increase 27 percent y-o-y to ARP 12.7 billion in July -- above expectations.
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¶9. July federal tax revenues increased 27 percent y-o-y to ARP 12.7 billion -- above market expectations of ARP 12.2 billion. Labor contributions were up 47 percent y-o-y due to increases in formal job creation and salary increases, while VAT revenues rose 26 percent y-o-y, mainly due to increased economic activity. Income tax and export tax revenues increased 26 percent y-o-y and 15 percent y-o-y, respectively. In real terms, revenues increased 14 percent y-o-y. July tax revenues reached ARP 83 billion in the first seven months of the year (a 22 percent y-o-y increase), reaching 58 percent of the BCRA consensus survey forecast of ARP 143.2 billion for 2006.

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2007 budget macroeconomic parameters may include 4.5 percent GDP growth and 8-11 percent inflation.
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¶10. On August 2, El Cronista reported preliminary macroeconomic projections that the GOA will likely include in the 2007 budget -- which is expected to be sent to Congress on September 15. Reportedly, the projections include: 4.5 percent GDP growth, an 8-11 percent inflation band and a primary fiscal surplus totaling 3 percent of GDP. For 2007, the BCRA consensus survey predicts 6 percent GDP growth, an 11-12 percent inflation band and a primary fiscal surplus of 3.2 percent of GDP. GOA officials said that the projections are moderate because Argentine economic history is not a certain matter. The 2007 budget would not include any reference to the "hold-out" bondholders problem. [The "hold-out" bondholders did not participate in the 2005 public debt exchange so the GOA has outstanding debt with them.]

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Banks pay USD 125 million in discount borrowing from the BCRA.

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¶11. On August 2, banks canceled another USD 125 million in discount borrowing from the BCRA. The payment is part of the BCRA's "matching" program, which matches the terms of bonds held by the banks with those of the discount debt. During the last 19 months, banks have repaid 69 percent of their loans and the number of banks with outstanding discount debt fell from 24 to 3 (Galicia Bank, Provincial Bank of Buenos Aires and Bisel).

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Mercosur central bank presidents will meet in Uruguay.
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¶12. Presidents of the Mercosur countries' central banks will gather on August 7-8 in Uruguay. The agenda includes discussion over the creation of a regional Mercosur Bank, a new transaction currency for use in commercial transactions between Argentina and Brazil and the issuance of a common bond.

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The GOA wants to control rising rent prices.
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¶13. Secretary of Internal Trade Guillermo Moreno is working to reach an agreement with the real estate sector on the issue of rising rent prices. According to the National Bureau of Statistics (INDEC), rents have increased 7.2 percent in 2006, while the CPI increased 4.9 percent. Moreno hopes to reach a voluntary agreement without resorting to a price freeze.

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Banco Nacion has a new vice-president.
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¶14. On July 28, the GOA designated Roberto Jose Feletti as the new vice-president of Banco Nacion. Feletti was secretary of planning and infrastructure for the City of Buenos Aires, and before that served as president of Banco Ciudad de Buenos Aires. Felleti's term will last until December 2007.

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July labor demand index down 1.01 percent m-o-m.
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¶15. The July labor demand index calculated by Di Tella University decreased 1.01 percent m-o-m to 111.77 points, after a 7.18 percent increase in June. Labor demand has decreased 2.02 percent so far this year. The decrease is mainly due to a fall in the demand for services (-3.46 percent), as well as for administrative and commercial personnel (-2.34 percent and -1.76 percent, respectively). The index is up 6.7 percent y-o-y. [The index is based on comparisons of job vacancy announcements printed in the two largest newspapers of the country.]

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Oil-producing provinces and the GOA agree on a Federal Hydrocarbon Law bill.
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¶16. Nine out of Argentina's ten oil and gas-producing provinces reached an agreement with the GOA on a Federal Hydrocarbon Law bill, which will now be sent to Congress for approval. This law would give provinces control over exploration and use of their natural resources, including administration of permissions, concessions and royalties. According to the bill, the GOA will remain in charge of the nation's energy policy as a whole. The nine provinces that signed are Mendoza, Chubut, Formosa, Jujuy, La Pampa, Rio Negro, Salta, Santa Cruz and Tierra del Fuego. All are members of the Federal Organization of Hydrocarbon-Producing Provinces (OFEPHI). The province of Neuquen, which has withdrawn from OFEPHI, did not sign the bill. According to press reports, Neuquen's governor is considering a run against President Nestor Kirchner in the 2007 elections.

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The GOA will increase employees' pension fund contributions to 11 percent.
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¶17. On July 27, the GOA issued a decree to gradually increase employees' required pension fund contributions. Currently, employees must contribute 7 percent of their earnings; in January it will rise to 9 percent. A second increase to 11 percent is scheduled for June 2007, bringing the contribution rate back to its pre-crisis level. The GOA decreased contributions from 11 percent to 7 percent in 2001, in an attempt to reactivate private consumption. Since then, the GOA has discussed increasing the contribution rate on several occasions, but it has remained at 7 percent until now.

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The GOA will issue a new Bonar bond.
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¶18. Secretary of Finance Alfredo Mac Laughlin announced preparations for a new Bonar issuance are underway, after the GOA successfully issued USD 500 million in Bonar V bonds on July 26. These dollar-denominated Bonar X bonds will have a ten-year term,

and they could be issued within the first two weeks of August.

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The BCRA requests USD 700 million from the BIS.
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¶19. The BCRA requested a USD 700 million credit from the Bank for International Settlements (BIS), which would be used to pay the USD 2.3 billion owed on Boden 2012 and 2007 capital due without diminishing reserves. The BCRA also asked for funds at the beginning of the year to restore its lost reserves after prepaying its debt to the IMF.

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Non-contributing pensioners pressure fiscal accounts.
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¶20. A measure that allows people above retirement age to sign up for retirement pensions, without ever having contributed to the social security system, is pressuring GOA fiscal accounts. The retirement payments for people that take advantage of this measure will be financed with public funds from the current pay-as-you-go retirement system. Private consultants estimate that if all 2.2 million eligible persons take advantage, it will cost approximately ARP 11.4 billion. This problem is perceived as one of the major consequences of the Argentina's high rate of informal employment (estimated at 45 percent).

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The IMF asks Argentina to reopen debt exchange.
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¶21. At their July 28 meeting, IMF members discussed the future of the "Argentine case." The IMF emphasized the importance of reopening the debt exchange, though its argument that new financing would be impossible was weaker after Argentina's successful bond issuance last week. Other recommended policies were revaluation of the peso exchange rate, restrictions on peso emissions, and reductions in government expenditures. Argentina has three outstanding debts: it owes money to "hold-out" bondholders and to the Paris Club, as well as accumulated interests with the European Investment Bank. This week, the GOA will decide if will allow publication of the IMF's report, which includes comments from Economic Minister Felisa Miceli and BCRA President Martin Redrado.

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BCRA rolls over its maturities and decreases rates for Lebacs and Nobacs.
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¶22. The BCRA received ARP 1.4 billion in bids at its August 1 Lebac and Nobac auction, compared to ARP 707 million in Lebacs that came due during the week. It accepted ARP 453 million in Lebac bids and ARP 436 million in Nobac bids. The yield on the 175-day Lebac decreased from 8.80 percent to 8.50 percent and on the 259-day Lebac decreased from 10.70 percent to 10.30 percent. The yield on the longest term instrument, the 343-day Lebac, decreased from 12.05 percent to 11.90 percent. Lebacs for maturities of more than 343 days were withdrawn due to lack of interest. The spread on the one-year Nobac decreased from 2.08 percent to 1.93 percent and the

two-year Nobac from 3.74 percent to 3.64 percent. The Badlar rate (the base rate for Nobacs) is currently at 9.5 percent. The BCRA changed its policy, accepting almost all Lebac bids and rejecting most Nobac bids, achieving a reduction of rates.

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The peso appreciated against the USD this week, closing at 3.09 ARP/USD.
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¶23. The peso appreciated versus the USD this week, closing at 3.09 ARP/USD. The BCRA is not reporting daily transactions in the dollar market until August 3, but the absence of reporting and a high dollar supply in the market pushed the peso exchange rate down against the USD. The peso exchange rate has depreciated 1.3 percent since the beginning of the calendar year. The BCRA's reserves stood at USD 26.2 billion as of July 21, and have increased USD 7.6 billion, or 41 percent, since the GOA prepaid its entire IMF debt on January 2.

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Commentary of the Week: "The Internal Market or Exports?" by Manuel Alvarado Ledesma, Director of the Agro-economic Consultancy (CAE), from an article published in La Nacion on July 22.
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¶24. Economics is the science of choices in conditions of scarcity. No matter what the choices are, not choosing is not an option. It is not possible to be both doctor and patient at the same time. This truism has become a nail in the heel of the current leaders. Obviously, this applies to some more than others. What does this reflection mean to us? The sudden devaluation - and its subsequent micro-devaluations - was permitted as a form of improving the

competitiveness of our economy abroad. Of clear mercantilist roots, the strategy, adopted as much by this government as by previous post-devaluation authorities, was clearly pro-exportation. The devaluation would improve the balance of trade and increase official resources, but it simultaneously would impoverish the internal market, affecting mainly the middle class and the most modest sectors, at least in the short term. On making this choice, the successive authorities should have known that internal prices would be extremely affected. However, it is as if they were surprised by the consequences; they decided to neutralize part of their negative effects on the internal market through the implementation of exportation laws on some products. Among these, those of the agriculture sector stand out.

¶25. The contradiction is clear. With the modification of the exchange rate, the price of food and of extractive activities rise, but the values of other products follow right behind - although to a different extent. Of course, the government applies export taxes to the first goods to rise, so that their prices are lower in the internal market and so that fiscal resources increase at the same time. And if such taxes do not produce all the effects desired, then the fiscal authority takes new measures to influence production.

¶26. The current absurdity is in wanting to stay in good terms with the internal market and at the same time trying to maintain a high dollar to encourage export activity, thus generating higher tax revenue. The strategy has the political logic of providing resources to the executive branch, but it implies the economic contradiction of trying to be in two places at the same time.

¶27. The government does not demonstrate clearly a calling for economic principles. Still, a central task remains incomplete: to define well what is, to the government's understanding, the nature and extent of state intervention in the economy. As it is today, the borders between the state and the market are blurred. Furthermore, they are unstable. In this context, there is no predictability, and therefore investment is scarce and will surely follow a path of short-term gains.

¶28. If one aims for economic stability and export growth, what is needed is a central bank, independent of political power, that is dedicated to maintaining the currency's value, a high grade of economic liberalization that places the country in the global economy, and a public expenditure that is as crystal clear as it is efficient. All this should be within a framework of enormous respect for private property and institutions, with clear and fixed regulations, that create a predictable horizon. The dollar matters, but the institutions that determine the transaction costs, and therefore productivity, matter much more.

¶29. On the contrary, the Central Bank is paradoxically promoting future inflation and sectoral struggle to increase sectoral incomes. In this way, it will surely unleash an internal struggle where each soldier will only succeed if his is able to give up what his opponent wants. In place of soldiers of production, we will instead have soldiers of the zero-sum game.

¶30. In summary: in its contradiction, economic policy is hurting the main link of the entire agro-industrial chain. And this is no small matter, as it makes up more than 35 percent of GDP. (Note: We reproduce selected articles by local experts for the benefit of our readers. The opinions expressed are those of the authors, not of the Embassy. End Note.)

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